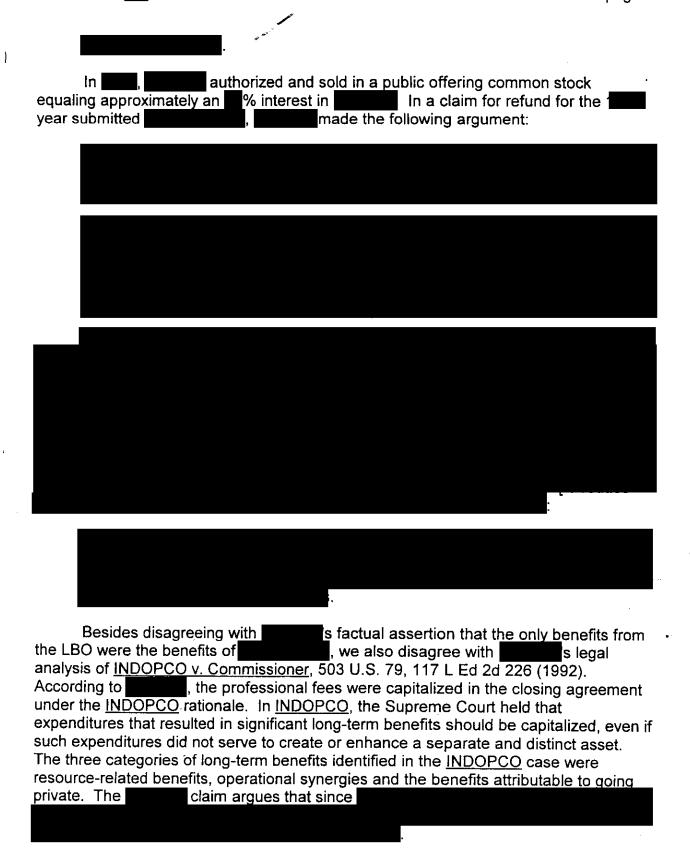
Internal Revenue Service memorandum CC:LM:CTM: :POSTF-124710-02 date: May 24, 2002 **Team Coordinator** to: from: Attorney (LMSB) subject: Joint Committee Review of Professional Fees Claim for Refund We recommend that the audit team reevaluate the proposed resolution of 's claim for refund regarding the taxable year professional fees issue. should be allowed a deduction in for previously incurred reorganization costs only to the extent can establish the existence and basis " If of the intangible asset of " cannot meet this heavy burden, this claim for refund should be disallowed in full. This memorandum should not be cited as precedent. (Our normal post-review procedure of this advice will serve to provide National Office coordination of this issue.) Issue: Can deduct as an abandonment loss in any portion of the capitalized professional fees incurred during the leveraged buy-out? Discussion: , entities (New) controlled by acquired % of the stock of (Old in a leveraged buy-out. Old was merged into the New entities and the parent New paid professional fees of approximately \$. Old connection with this acquisition. Old capitalized \$ of these fees and on its original return. The ensuing dispute over how deducted the remaining \$ much of said fees were deductible was resolved by allowing a current deduction of approximately \$ This resolution was recorded in a closing agreement that provided that the remaining portion of the fees represents:

Office of Chief Counsel



On the contrary, we think the INDOPCO opinion discussed these three long-term benefits because those benefits were present in that case, not because those were the only possible long-term benefits from a corporate merger. Far from limiting the scope to the holding to enumerated long-term benefits, the Supreme Court quoted with approval language from past decisions holding that expenses "incurred for the purpose of changing the corporate structure for the benefit of future operations are not ordinary and necessary business expenses." INDOPCO, supra, 117 L Ed 2d at 237 (citations omitted). Once capitalized, the general rule is that capitalized reorganization expenses are deductible only when a corporation liquidates: "efforts to deduct reorganization expenses before a taxpayer's final liquidation, upon an event such as recapitalization that eliminated stock previously created, have fail, and properly so." Bittker and Eustice, Federal Income Taxation of Corporations and Shareholders, \$\mathbf{\textit{1}} \in \text{5.06[2][h]} (7th Ed. 2000) (footnote omitted).

| may further argue that even if the LBO produced other benefits besides the benefits of the LBO did produce the benefits of so a portion of the capitalized professional fees should be allocated to such benefits, and that portion deducted in when the benefits were abandoned. This possibility appears to be theoretically consistent with Newark Morning Ledger v. United States, 507 U.S. 546 (1993), where the Supreme Court allowed a newspaper publisher to amortize an intangible asset (an acquired subscribers list) where the taxpayer established the basis and useful life of the intangible asset with reasonable accuracy. |
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| Under this approach, would have to establish the existence of a separate intangible asset (would have to establish the existence of a and its basis. We are not aware, however, of any contemporaneous statements or other evidence in connection with the would tend to establish either the existence or the basis of a "intangible asset. The contemporary statement of quoted above, regarding splans to become a public company tends to establish the opposite – far from being a valuable benefit, to |
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| Another consideration is the language of the closing agreement. The closing agreement states only that the capitalized fees were incurred " |
| about sacquisition of the benefits of of the bene |
| ownership, could argue that the closing agreement language is consistent with the acquisition of the benefits of could argue that the closing agreement language is consistent with the acquisition of the benefits of closing agreement. We believe that evidence of the existence and basis of a consistent with the closing agreement. |

Lastly, we note that the recently issued Advance Notice of Proposed Rulemaking (ANPR) concerning capitalization of intangibles, Announcement 2002-9 (February 19, 2002), does not appear to bear on this issue. Under Section C., Transaction Costs, the ANPR states that the proposed rule is expected to require capitalization of transaction costs that facilitate the taxpayer's acquisition, creation, restructuring, or reorganization of a business entity. The ANPR does not, however, discuss any circumstances where capitalized transaction costs later become deductible.

If you have any questions, please contact me.

Attorney (LMSB)

cc: Area Counsel Team Manager